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MICHAEL RODAK, JR.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-1323

GENERAL MOTORS ACCEPTANCE CORPORATION AND DAVE WAITE PONTIAC, INC.,

Petitioners,

vs.

WILLARD D. EASON, M. O. SATROM, AND JEAN M. SATROM,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The petitioners request that a Writ of Certiorari issue to review the judgment of the Court of Appeals for the Seventh Circuit entered in the above cause on December 28, 1973.

OPINIONS BELOW

The opinion of the Court of Appeals has not been reported. A copy is appended as *Appendix I.* No opinion was written by the District Court but copies of its orders sustaining petitioners' motions to dismiss respondents' action for want of standing to maintain it under § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder by the Securities Exchange Commission are appended as *Appendix II.*

JURISDICTION

The judgment of the Court of Appeals was entered December 28, 1973. A petition for rehearing was filed by petitioners January 11, 1974, and was denied January 23, 1974. See *Appendix I*. The jurisdiction of this Court is invoked under 28 U. S. C. §§ 1254(1) and 2101(c).

QUESTION PRESENTED

The question presented for review is whether, notwithstanding respondents were neither purchasers nor sellers of any security, they may nevertheless maintain a private action under § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder by the Securities Exchange Commission.

STATUTE AND REGULATION INVOLVED

Section 10(b) of the Securities Act of 1934, 48 Stat. 891, 15 U. S. C. § 78j(b) provides:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> * * * * *
>
> "(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange, or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule 10b-5 provides:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> "(a) To employ any device, scheme, or artifice to defraud,

"(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(c) To engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." 17 C. F. R. § 240. 10b-5.

STATEMENT OF THE CASE INCLUDING BASIS FOR FEDERAL JURISDICTION

The petitioners are General Motors Acceptance Corporation ("GMAC"), a New York corporation, and Dave Waite Pontiac, Inc. ("Waite Pontiac"), an Indiana corporation and a General Motors Corporation ("GM") automobile dealer which, prior to the transactions involved here, also operated an automobile leasing division ("Waite Leasing"). GMAC is engaged principally in the business of financing the acquisition by dealers for resale of new products manufactured by GM and acquiring from such dealers retail installment obligations covering sales (including certain leasing transactions) of new products. At the time of the transactions involved here, GMAC held numerous chattel mortgage notes executed by Waite Pontiac in connection with the purchase of automobiles for use in Waite Leasing's operation.

The respondents are shareholders of Bank Service Corporation ("Bank Service"), an Indiana corporation. The amended complaint[1] alleges that on or about October 31, 1969, Bank Service, as the buyer, entered into a written contract with Waite Pontiac, as the seller, for the purchase of Waite Leasing. By the terms of the contract, Bank Service assumed Waite Pontiac's existing chattel mortgage indebtedness to GMAC and agreed to

1. The certified record filed in this Court includes as Document No. 1 Appellants' Appendix filed October 10, 1972, in the Court of Appeals for the Seventh Circuit. Record references herein are to that Appendix.

transfer to Waite Pontiac 7,000 shares of Bank Service stock of an agreed value of one dollar ($1.00) per share. (R., p. 5A; Ex. A, pp. 14A-18A.) The contract also contained a provision that the shareholders of Bank Service would agree to indemnify Waite Pontiac against liability to GMAC on account of the chattel mortgage indebtedness of Waite Pontiac which Bank Service had assumed and agreed to pay, and the shareholders, including respondents, who were its principal shareholders, officers and directors, therefore executed as an addendum to the contract a separate covenant agreeing to indemnify Waite Pontiac against liability to GMAC. (R., p. 18A.) GMAC was not a party to the purchase contract.

The amended complaint further alleges that GMAC agreed to permit the transfer of the assets of the leasing operation to Bank Service, and to finance a new leasing operation to be conducted by Bank Service, and/or its wholly owned subsidiary General Auto Leasing & Rental Corporation ("GAL"), upon condition that persons of substantial financial worth would guarantee payment to GMAC of the existing obligations assumed by Bank Service and of any future obligations of Bank Service or such wholly owned subsidiary. (R., p. 4A.)

In order to comply with the above condition, respondents, in a transaction distinct from the sale described above, executed and delivered to GMAC two separate written guarantees. In the first, respondents guaranteed the payment by Bank Service of all indebtedness owing or to be owed to GMAC (R. Ex. C, pp. 22A-24A), while in the second, respondents guaranteed payment by GAL of all obligations owed or to be owed by it to GMAC (R. Ex. B, pp. 19A-21A). Waite Pontiac is not alleged to have been a party to the credit transaction between respondents and GMAC.

Waite Pontiac and GMAC are alleged to have violated § 10(b) of the Securities Exchange Act and Rule 10b-5 during the negotiations between Bank Service, GMAC and Waite Pontiac by having made untrue statements of material facts and

by having failed to state material facts with respect to the business, the financial condition and the properties of Waite Pontiac and Waite Leasing, thereby concealing from respondents and Bank Service material adverse conditions of such business, financial position and properties, and also by having withheld information concerning certain policies and practices of the management of Waite Pontiac, GMAC and GM which should have been revealed.

Bank Service and/or GAL allegedly conducted the purchased leasing business for more than a year and a half at which time they became insolvent by reason of alleged operating losses. Thereafter, GMAC brought a state court action against respondents on the guaranties, in which respondents counterclaimed for damages and rescission of their guaranties, which remains pending. Respondents then commenced this federal court action against petitioners, jurisdiction being asserted under § 27 of the Securities Exchange Act of 1934, 15 U. S. C. § 78aa. The respondents' amended complaint in this action seeks to recover compensatory and punitive damages, and to have the guaranties and all evidences of indebtedness relating thereto rescinded and declared void.

The District Court for the Southern District of Indiana sustained petitioner's motions to dismiss on the ground that respondents, under their own allegations, were neither purchasers nor sellers of securities and consequently lacked standing to maintain this action under the rule originally enunciated in *Birnbaum* v. *Newport Steel Corp.*, 193 F. 2d 461 (2d Cir.), *cert. denied*, 343 U. S. 956 (1952), that only purchasers or sellers of securities may maintain a private action under § 10(b) and Rule 10b-5.

The Court of Appeals for the Seventh Circuit did not disagree with the District Court's conclusion that respondents were neither purchasers nor sellers of securities in the context of the described transactions. Nevertheless, it reversed the decision of the District Court. The Court of Appeals held that the *Birnbaum* purchaser-seller requirement is no part of the law of the Seventh

Circuit and that respondents therefore were entitled to maintain their § 10(b) and Rule 10b-5 action notwithstanding they were neither purchasers nor sellers of securities. The rationale of the Court of Appeals in reversing the judgment of the District Court was that under the allegations of the complaint, the transfer of the Bank Service stock to Waite Pontiac constituted a sale of securities in violation of § 10(b) and Rule 10b-5 as a result of which Bank Service could have maintained an appropriate action under the statute and rule; that although respondents were not the sellers of said stock, they were shareholders of Bank Service and presumably executed the guaranties on account of their interest as such shareholders; and that since such execution is alleged to have been induced by the same fraud or deceit which allegedly induced Bank Service to sell its stock, they are "persons" upon whom the acts of the petitioners operated as fraud or deceit "in connection with the purchase or sale of any security," although they were neither purchasers nor sellers either of the securities involved in connection with the alleged rule violation or of any other securities.

REASONS FOR GRANTING THE WRIT

1. The Decision of the Court of Appeals for the Seventh Circuit Is in Conflict with the Decision of Every Other Court of Appeals That Has Considered the Birnbaum Doctrine.

The decision of the Court of Appeals for the Seventh Circuit in this case is in conflict with the decision of every other Court of Appeals that has considered the purchaser-seller requirement for standing to sue under § 10(b) of the Securities Exchange Act and Rule 10b-5 of the Securities Exchange Commission.[2]

2. See *Landy* v. *Federal Deposit Insurance Corporation*, 486 F. 2d 139, 152-59 (3rd Cir. 1973), *petition for certiorari filed*, 42 U. S. L. W. 3336 (No. 73-819, November 23, 1973); *Haberman* v. *Murchison*, 468 F. 2d 1305, 1311 (2d Cir. 1972); *Mount Clemens Industries, Inc.* v. *Bell*, 464 F. 2d 339 (9th Cir. 1972); *Dudley* v. *Southeastern Factor and Finance Corp.*, 446 F. 2d 303

The decision here represents the first instance in which a court of appeals has rejected the view, initially set forth in *Birnbaum* v. *Newport Steel Corp.*, 193 F. 2d 461, 464 (2d Cir.), *cert. denied*, 343 U. S. 956 (1952), that Rule 10b-5 "extended protection only to the defrauded purchaser or seller." The Seventh Circuit made its position abundantly clear with its conclusion in this case that the purchaser-seller limitation "is not part of the law of this circuit." (App. I. p. A13.)

Continued efforts in recent years both by litigants, and by the Securities Exchange Commission as amicus curiae, to obtain repudiation of the *Birnbaum* purchaser-seller limitation have caused a number of the Courts of Appeals to review the question, but prior to this case such efforts have been notably unsuccessful. Only recently the *Birnbaum* rule was reaffirmed by the Court of Appeals for the Third Circuit in *Landy* v. *Federal Deposit Insurance Corporation*, 486 F. 2d 139 (1973), *petition for certiorari filed*, 42 U. S. L. W. 3336 (No. 73-819, November 23, 1973), where the court explained as follows:

> "Although various courts and commentators have suggested elimination of the purchaser-seller requirement, each of the circuit courts of appeals that has ruled on this question recently has affirmed the basic *Birnbaum* rule that standing under 10b-5 in a suit *for damages* requires purchaser-seller status.[3] The reasons for retaining

(5th Cir.), *cert. denied*, 404 U. S. 858 (1971); *Herpich* v. *Wallace*, 430 F. 2d 792 (5th Cir. 1970); *Simmons* v. *Wolfson*, 428 F. 2d 455 (6th Cir. 1970), *cert. denied*, 400 U. S. 999 (1971); *Erling* v. *Powell*, 429 F. 2d 795 (8th Cir. 1970); *City Nat. Bank* v. *Vanderboom*, 422 F. 2d 221 (8th Cir.), *cert. denied*, 399 U. S. 905 (1970); *Iroquois Industries, Inc.* v. *Syracuse China Corp.*, 417 F. 2d 963 (2d Cir. 1969), *cert. denied*, 399 U. S. 909 (1970).

3. Respondents in this case seek both damages and equitable relief by way of rescission of the guaranties and have urged on the basis of cases dispensing with the purchaser-seller requirement in injunction cases (cf. *Mutual Shares Corporation* v. *Genesco, Inc.*, 384 F. 2d 540 (2d Cir. 1967)) that even though not entitled to maintain an action for damages they should be entitled to the equitable relief sought. The Court of Appeals in this case made no such distinction. In *Heyman* v. *Heyman*, 356 F. Supp. 958, 964

> the standing requirement are posited as essentially two fold: first, the purpose of Congress in enacting section 10(b) was merely to extend to sellers of securities the same protection that had been afforded to buyers under the 1933 Securities Act; second, only Congress should change an interpretation of an act unbroken since its passage. *See, e.g.*, Iroquois Industries, Inc. v. Syracuse China Corporation, 417 F. 2d 963 (2d Cir. 1969); Herpich v. Wallace, 430 F. 2d 792 (5th Cir. 1970). . . .
>
> ". . . Were we to extend the provisions of section 10(b) beyond the buyer or seller relationship, we would be judicially extending the terms of the statute and creating new rights. The consequences of the view urged by plaintiffs would establish a new and amorphous body of rights and obligations heretofore unrecognized in federal jurisdiction. Buyer or seller status is indispensable in establishing liability for damages under rule 10b-5." 486 F. 2d 156-57, 158.

Perhaps what is most striking about the opinion of the Seventh Circuit is that it seemingly ignores the basic point relied upon in *Landy* as support for the *Birnbaum* rule, namely, that it was Congress' intent, in enacting § 10(b), "merely to extend to sellers of securities the same protection that had been afforded to buyers under the 1933 Securities Act." Indeed, this has been the primary consideration underlying the purchaser-seller limitation since the decision of *Birnbaum* itself. See 193 F. 2d at 463. Yet apparently without concern for this essential consideration, the Seventh Circuit has abandoned the purchaser-seller limitation and, in doing so, has left an unfilled void in its place. Thus, the Court of Appeals readily acknowledged that it would not "try to formulate a succinct substitute for *Birnbaum*, trusting that the appropriate limits to the rule will best

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(S. D. N. Y. 1973), the court pointed out that the injunction cases have sought to enjoin deceptive practices when resultant loss to stockholders had not yet occurred, and that if *Birnbaum* could be discarded whenever a complaint prayed equitable relief with respect to a consummated transaction the exception would largely "envelop the rule."

be defined through the process of case by case adjudication."[4] (App. I, p. A12 n. 29.) In short, then, the Seventh Circuit not only has seemingly rejected the heretofore recognized significance of Congress' intent in enacting § 10(b) but has also failed to offer any meaningful construction of the standing requirement to replace the structure that has been developed on the basis of that intent in *Birnbaum* and its numerous progeny. Certainly, it is not difficult to imagine the unsettling effect which the Seventh Circuit's decision will have on litigation under § 10(b) and Rule 10b-5.

The Third Circuit's opinion in *Landy* raises the equally important question whether the Seventh Circuit has exceeded the scope of its function of statutory interpretation—as opposed to statutory drafting—in abandoning the purchaser-seller limitation which has long been recognized to be rooted in the intent of Congress. This consideration has clearly been a significant factor in previous decisions concerning the *Birnbaum* rule. Thus, in *Iroquois Industries, Inc.* v. *Syracuse China Corp.*, 417 F. 2d 963 (2d Cir. 1969), *cert. denied*, 399 U. S. 909 (1970), the Court of Appeals for the Second Circuit, although invited by the appellant and the Securities Exchange Commission as amicus curiae to overrule *Birnbaum*, affirmed its original decision there, stating that, in the light of the history set forth in *Birnbaum*, the statute and rule were intended only to extend protection to the "defrauded purchaser or seller." The court then added:

> "The *Birnbaum* rule recognizes the policy of Congress in enacting Section 10(b) and of the Commission in adopting Rule 10b-5, namely, *the protection of defrauded purchasers and sellers*. It is not the province of the courts to

4. Applying such a process to the present case yields only the rather surprising conclusion that if a shareholder of a corporation which purchases or sells a security as a result of alleged fraud or deceit, engages, because of his interest as a shareholder and because of the same fraud or deceit, in a transaction which involves neither the sale nor the purchase of any security, he is entitled to a remedy under the statute and rule to redress any injury alleged to have been sustained.

extend Section 10(b) to apply to transactions not intended to be covered by Congress. We do well to heed the words of Mr. Justice Black, writing for the Court in a case about another section of the 1934 Act, Blau v. Lehman, 368 U. S. 403, 413, 82 S. Ct. 451, 457, 7 L. Ed. 2d 403 (1962):

> " 'Congress can and might amend [the Act] if the Commission would present to it the policy arguments it has presented to us, but we think that Congress is the proper agency to change an interpretation of the Act unbroken since its passage, if the change is to be made.'

"That the conduct averred in any given case may be reprehensible does not mean that a federal remedy must be furnished by judges. . . . If there is to be a federal remedy, it is the Congress which must create it." 417 F. 2d at 969 (emphasis added).

See also Mount Clemens Industries, Inc. v. *Bell,* 464 F. 2d 339, 343 (9th Cir. 1972):

> "Although this language was directed to Section 16(b) of the Exchange Act. . . . we agree with our colleagues of the Second Circuit that it applies with equal force to Section 10(b)."

2. The Decision of the Court of Appeals for the Seventh Circuit Cannot Be Rationalized Under Even the Most Liberal Application That the Birnbaum Doctrine Has Heretofore Been Given.

Substantially all of the Courts of Appeals have, to be sure, recognized that the purchaser-seller limitation is to be read "flexibly." As stated in *Herpich* v. *Wallace,* 430 F. 2d 792, 806 (5th Cir. 1970):

> "We do not say that only those who are purchasers or sellers in the 'strict common law traditional sense' . . . may maintain an action for damages under Rule 10b-5. . . . In deciding whether a plaintiff has standing, we search for what will best establish the congressional purpose . . . Thus we construe the 'in connection with the purchase or

> sale of any security' clause found in both the section and the rule broadly and flexibly to effectuate that purpose. . . . The 'purchaser'—'seller' standing requirement is to be similarly construed . . . so that the broad design of the section and the rule is not frustrated by the use of novel or atypical transactions."

Likewise, *Landy* indicates that while precise guidelines have not been formulated as to when the flexible view of Rule 10b-5 will permit standing in the absence of technical purchaser or seller status, the one criterion generally reiterated is whether standing would effectuate the broad purpose of the rule. See 486 F. 2d at 157. Presumably it was the lack of more precise guidelines to the application of the purchaser-seller limitation that caused the Court of Appeals for the Seventh Circuit to state in this case:

> ". . . Nor does the so-called rule really have integrity when the words 'purchaser' and 'seller' are construed as flexibly as has been necessary in order both to decide 10b-5 cases properly and also to continue to pay homage to the *Birnbaum* rule." (App. I, p. A9.)

Yet contrary to the apparent view of the Court of Appeals, it is clear that the courts applying the flexible interpretation of *Birnbaum* have never lost sight of Congress' basic purpose to extend relief *only* to buyers or sellers of securities in the context of § 10(b) and Rule 10b-5.

In *SEC* v. *National Securities, Inc.*, 393 U. S. 453 (1969), where this Court interpreted § 10(b) and Rule 10b-5 for the first time, it was held that the exchange of shares by shareholders of one company for shares of another company with which their company was merging was a "purchase" of shares within the terms of the statute and the rule. At one point, the Court stated:

> "This case presents none of the complications which may arise in determining who, if anyone, may bring private actions under § 10(b) and Rule 10b-5. Cf. *J. I. Case Co.* v. *Borak*, 377 U. S. 426 (1964). This is a suit brought

> by the Commission; the terms 'purchase' and 'sale' are relevant only to the question of the statutory coverage. Therefore there are no 'standing' problems lurking in the case. . . ." 393 U. S. at 467 n. 9.

Still, confronted with the question "whether the respondents' alleged conduct is the type of fraudulent behavior which was meant to be forbidden by the statute and the rule," the Court explained:

> "According to the amended complaint, Producers' shareholders were misled in various material respects prior to their approval of a merger. The deception furthered a scheme which resulted in their losing their status as shareholders in Producers and becoming shareholders in a new company. Moreover, by voting in favor of the merger, each approving shareholder individually lost any right under Arizona law to obtain an appraisal of his stock and payment for it in cash. Ariz. Rev. Stat. Ann. § 10-347 (1956). Whatever the terms 'purchase' and 'sale' may mean in other contexts, here an alleged deception *has affected individual shareholders' decisions in a way not at all unlike that involved in a typical cash sale or share exchange.* The broad antifraud purposes of the statute and the rule would clearly be furthered by their application to this type of situation. Therefore we conclude that Producers' shareholders 'purchased' shares in the new company by exchanging them for their old stock." 393 U. S. at 467 (emphasis added).

Thus, the rationale employed in *National Securities* was that the shareholders of the old company were "purchasers" of shares within the meaning of § 10(b) and Rule 10b-5 because the alleged deception affected their investment decisions in a way not unlike that involved in an investment decision to purchase or sell securities. Similar reasoning was also applied in *Herpich* v. *Wallace*, 430 F. 2d 792 (5th Cir. 1970), where the court said:

> "In short, Congress meant to afford investors a reasonable opportunity *to make knowing, intelligent decisions regarding their purchases and sales of securities* in un-

> manipulated markets, . . . and the loss resulting in connection with purchases or sales made without benefit of such an opportunity is the type of injury section 10(b) and Rule 10b-5 seek to prevent." 430 F. 2d at 806. (Emphasis added.)

In other words, decisions giving liberal application to the *Birnbaum* doctrine have generally been rationalized on the basis either that the transaction in which the injured party participated had sufficient basic elements of a sale or purchase of the securities involved in the alleged rule violation to bring him within the broad purpose of the rule, or that the injured party had sufficient relation to the transaction in which the purchase or sale of the securities involved in the rule violation occurred to make him a seller or purchaser of such securities within such broad purpose.[5] There is, however, an obvious basic difference between a flexible interpretation of "sale", "purchase", "seller" or "purchaser" which is limited to situations in which the injured party is linked directly to the securities involved in a rule violation, and an interpretation of "any person" upon whom an "act" or "practice" has operated "as a fraud or deceit" "in connection with the purchase or sale of a security" which dispenses altogether with the requirement that such person be either a seller or purchaser—technically or under the flexible view—of the security involved in the rule violation.

This distinction was clearly recognized by the Court of Appeals for the Second Circuit in *International Controls Corp.* v. *Vesco et al.*, ... F. 2d ..... (2d Cir. January 15, 1974, Nos. 73-2202, 73-2255, 73-2568), slip opinion at p. 1399 (Mulligan J. dissenting in part). The majority held that an in-kind dividend of a corporation to its shareholders of the stock

5. Thus, for example, in *National Securities*, the merger was held to have sufficient basic elements of a sale to make the transaction a "sale" of securities in the context of the statute and rule, while in *James* v. *Gerber Products Co.*, 483 F. 2d 944 (6th Cir. 1973), a trust beneficiary was held to be a "seller" of the securities involved in the rule violation because she was the person benefited by the sale and therefore had the interest of a *de facto* seller.

of a wholly owned subsidiary which was induced by fraud was a sale of such stock within the meaning of § 10(b) and Rule 10b-5, even though the corporation received no consideration therefor. While the holding may have extended the flexible concept of "sale" beyond prior decisions, the majority rejected the suggestion of the dissenting Judge that it signalled the demise of *Birnbaum:*

> "Our dissenting brother's 'fear' that our decision today signals the demise of the *Birnbaum* doctrine—limiting standing to sue under § 10(b) to the 'purchaser or seller' of securities—is wholly unfounded. Having determined that ICC's dividend of its Fairfield General portfolio stock was the kind of meaningful disposition of securities which Congress sought to protect under § 10(b), it could not be more clear that ICC was the 'seller' of those securities. Compare *Birnbaum* v. *Newport Steel Corp., supra* (the corporation lacked standing where its controlling shareholder sold *his shares*) with *Ruckle* v. *Roto American Corp., supra* (the corporation had standing where it had agreed to sell its own newly-issued shares)." Slip Op. at p. 1419 n. 16.

Essentially the same distinction between *Birnbaum* and *Ruckle* v. *Roto American Corp.*, 339 F. 2d 24 (2d Cir. 1964), that was put forth in *Vesco* must be said to apply in this case, only in reverse. For if a corporation lacks standing to sue under the rule where its controlling shareholder sold his shares of the corporation, it must follow that shareholders lack personal standing where, as here, the corporation sold its own shares. As the Court of Appeals conceded, the only purchase or sale of a security involved in this case was the transfer of 7,000 shares of stock from Bank Service to Waite Pontiac and respondents could not be characterized as sellers of that stock under the most flexible view of the *Birnbaum* doctrine. Consequently, the court was compelled either to repudiate the *Birnbaum* doctrine or to attempt somehow to extend that doctrine beyond any previous application. In the latter regard, respondents contended both that they were purchasers of securities, by reason that their

guaranty of the indebtedness of Bank Service to GMAC was in effect an agreement to purchase notes evidencing such indebtedness in the event of insolvency, and that they were sellers of securities, by reason of the delivery of such guaranty to GMAC. The guaranty transaction, however, was obviously not an investment transaction by respondents but an ordinary commercial credit transaction not within any purpose of the statute and rule. Cf. *Lino* v. *City Investing Co.*, 487 F. 2d 689 (3d Cir. 1973), and *McClure* v. *First National Bank*, 352 F. Supp. 454 (N. D. Tex. 1973). Therefore, the Court of Appeals chose the only alternative actually available if it was to rule for respondents —it repudiated the *Birnbaum* doctrine completely. It is, then, the continuing viability of that doctrine which is squarely presented to this Court by the decision below.

3. This Court Has Not Heretofore Passed Upon the Correctness of the Birnbaum Doctrine.

While conceding that no holding of this Court is inconsistent with the view that only purchasers or sellers of securities are protected by Rule 10b-5, the Court of Appeals for the Seventh Circuit purported to find support for the rejection of the purchaser-seller requirement in *Superintendent of Ins.* v. *Bankers Life & Casualty Co.*, 404 U. S. 6 (1971). The court's argument is twofold.

First, the Court of Appeals stated that Congress, the Supreme Court, and the Commission have all used the term "investors" to describe the class of persons protected by Rule 10b-5 and the statutory authorization for the rule refers to the prohibition of deceptive devices " 'for the protection of investors.' " It then added: "And speaking for a unanimous court in *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, Justice Douglas stated that the crux of the case was the fact that 'Manhattan suffered injury as a result of deceptive practices touching its sale of securities *as an investor*.' 404 U. S. 6, 12-13 (emphasis

added.)" (App. I, p. A9). By adding emphasis only to the words "as an investor" the Court of Appeals minimized the significance of the preceding language "touching *its sale of securities.*" (Emphasis added.) In fact, this Court in *Bankers Life* also said:

> "Manhattan *was the seller* of Treasury bonds and, it seems to us, clearly protected by § 10(b) . . . of the Securities Exchange Act, which makes it unlawful to use 'in connection with the purchase or sale' of any security, 'any manipulative device or contrivance' in contravention of the rules and regulations of the Securities and Exchange Commission.
>
> "There certainly was an 'act' or 'practice' within the meaning of Rule 10b-5 which operated 'as a fraud or deceit' on Manhattan, the *seller* of the Government bonds." 404 U. S. at 9. (Emphasis added.)

Hence, it appears wholly unreasonable to attach the significance which the Court of Appeals attaches to this Court's usage of the word "investor" in *Bankers Life*.

The Court of Appeals further stated that the "basic holding" of *Birnbaum* was repudiated in *Bankers Life*, and that it was convinced that the purchaser-seller limitation is nothing more than an appendage to that holding without independent justification. (App. I, p. A13.) Four other Courts of Appeal have, however, previously rejected the contention that *Bankers Life* warrants repudiation of the purchaser-seller limitation by implication or otherwise. Thus, for instance, in *Haberman* v. *Murchison*, 468 F. 2d 1305, (2d Cir. 1972), the court, after stating that Section 10(b) and Rule 10b-5 afford protection only to those who actually purchase or sell securities to their loss in reliance upon the withholding or misrepresentation of material information or other manipulative or deceptive devices, said:

> "Nothing in the Supreme Court's opinion in Supt. of Insurance of New York v. Bankers Life and Cas. Co., 404 U. S. 6, 92 S. Ct. 165, 30 L. Ed. 2d 128 (1971), is to the contrary. Although the Court there reversed this court's

> holding that Section 10(b) extended only to fraudulent or manipulative sales and not to the fraudulent appropriation of the proceeds of a sale, it in no way suggested a rejection of the rule that a plaintiff under Section 10(b) *must be a party to the sales transaction.* The Court made clear
>
> > 'that Manhattan [the injured party] was the *seller* of Treasury bonds and, it seems to us, clearly protected by § 10(b) . . . The Act protects corporations as well as individuals who are *sellers* of a security.' 404 U. S. at 9, 10, 92 S. Ct. at 167-168. (Emphasis supplied.)"
>
> 468 F. 2d at 1311 n. 5 (first emphasis added).

See also *Landy* v. *Federal Deposit Insurance Corporation*, 486 F. 2d 139, 155 (3d Cir. 1973), *petition for certiorari filed*, 42 U. S. L. W. 3336 (No. 73-819, November 23, 1973); *James* v. *Gerber Products Co.*, 483 F. 2d 944, 948 (6th Cir. 1973); *Mount Clemens Industries, Inc.* v. *Bell*, 464 F. 2d 339, 344 (9th Cir. 1972). Indeed, it appears clear from this Court's own opinion in *Bankers Life* that the question of the limitations on standing to sue under § 10(b) and Rule 10b-5 was there reserved for future consideration. See 404 U. S. at 13-14 n. 10. Certainly, it cannot be said that the purchaser-seller limitation was rejected in that decision.

4. The Decision of the Court of Appeals for the Seventh Circuit Involves an Important Question of Federal Law Requiring Resolution by This Court.

The purchaser-seller requirement has long been recognized to be an important limitation on the use by private parties of § 10(b) and Rule 10b-5 to seek redress for injury resulting from fraud. The Court of Appeals in this case readily assumed that "complete abandonment of *Birnbaum* will significantly increase our workload," but refused to accept this as a reason for rejecting what it believed "to be a correct interpretation of the statute or the rule." (App. I, p. 12.) Without question, the practical impact of any particular interpretation of a statute is not a rele-

vant consideration in the process of statutory interpretation, the exclusive purpose of which is to determine the intent of Congress in enacting the statute in question. Nevertheless, the practical impact of the interpretation adopted by the Seventh Circuit—that is, the extension of § 10(b) and Rule 10b-5 to apparently large numbers of potential suitors who previously could not invoke the statute or the rule—is certainly a highly relevant consideration in assessing the importance of the decision below. And this consideration is amplified here by the failure of the Court of Appeals, in rejecting *Birnbaum*, to suggest any alternative standards which should govern standing under § 10(b) and Rule 10b-5, thus giving emphasis to the Landy statement that "The consequences of the view urged by plaintiffs would establish a new and amorphous body of rights and obligations heretofore unrecognized in federal jurisdiction." 486 F. 2d at 158.

In sum, an area of such federal significance should not be left in its present unsettled state, particularly not when the position of the Seventh Circuit conflicts with that of every other circuit which has considered the question. The Court of Appeals was, of course, well aware of the disuniformity in federal law which would result from its decision, but it did not believe "that *Birnbaum* should be followed simply to preserve national consistency in the interpretation of federal securities legislation." (App. I, p. 13.) Under such circumstances, as the Court of Appeals further recognized, "the only sure way to achieve consistency throughout the federal judiciary on a question of this character is for the Supreme Court to resolve such conflict among the circuits as does exist." (App. I, p. 13.)

CONCLUSION

For the reasons stated, it is respectfully submitted that the petition for certiorari should be granted.

Respectfully submitted.

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APPENDIX I

IN THE UNITED STATES COURT OF APPEALS
For the Seventh Circuit

September Term, 1973 — September Session, 1973

No. 72-1722

WILLARD D. EASON, M. O. SATROM and JEAN M. SATROM,
Plaintiffs-Appellants,

vs.

GENERAL MOTORS ACCEPTANCE CORPORATION and DAVE WAITE PONTIAC, INC.,
Defendants-Appellees.

Appeal from the United States District Court for the Southern District of Indiana.

No. IP 71 C 613

CALE J. HOLDER,
Judge.

Argued October 19, 1973—Decided December 28, 1973

BEFORE KILEY and STEVENS, *Circuit Judges*, and WYZANSKI, *Senior District Judge.**

STEVENS, *Circuit Judge*. Plaintiffs are shareholders of a corporation which purchased a car leasing business from one of the defendants. In connection with the transaction, the corporate purchaser issued 7,000 shares of its stock to the seller, and the plaintiffs individually guaranteed certain liabilities assumed by the purchaser. Plaintiffs accuse both defendants of

* Senior District Judge Charles Edward Wyzanski, Jr., of the District of Massachusetts, is sitting by designation.

fraud and seek relief under § 10(b) of the Securities Exchange Act of 1934,[1] 48 Stat. 891, 15 USC § 78j(b), and Securities and Exchange Commission Rule 10b-5.[2] The question presented is whether their claim is foreclosed by the so-called *"Birnbaum* rule" which limits private relief for a violation of Rule 10b-5 to persons who were either purchasers or sellers of a security.

The appeal is from an order dismissing plaintiffs' third amended complaint and denying leave to file a fourth. The essential facts are quite simple. Prior to October 31, 1969, one of the defendants (Dave Waite Pontiac, Inc.) operated a Pontiac dealership and also an automatic leasing division. Purchases of cars for the leasing business were financed by General Motors Acceptance Corporation, the second defendant. Bank Service Corporation, a company in which the plaintiffs owned stock, entered into an agreement to purchase the leasing business. As consideration for the business, Bank Service issued 7,000 shares of its stock to Waite and assumed

1. Section 10(b) of the Act provides:

"It shall be unlawful for any person . . . [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

2. Rule 10b-5 provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

"(a) To employ any device, scheme, or artifice to defraud,

"(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." 17 CFR § 240.10b-5.

the liabilities of the leasing business, including notes payable to GMAC, and the individual plaintiffs delivered a guarantee of those notes, as well as a guarantee of future liabilities, to GMAC.

The leasing business failed; Bank Service became insolvent and defaulted on the notes.[3] GMAC then brought suit in a state court to recover on the guarantees. Plaintiffs countered with this federal action, accusing both defendants of fraud and seeking rescission of the guarantees.

Plaintiffs seek to avoid *Birnbaum's* purchaser-seller limitation on private relief under Rule 10b-5 in various ways. They contend that their guarantees were securities which they sold to GMAC; that the underlying notes are securities which they are being forced to purchase; that they were indirect sellers of the 7,000 shares of corporate stock; and, in all events, that the *Birnbaum* limitation should be disavowed in this circuit. Since the necessity of stretching the definitions of "purchasers," "sellers," and "securities" is a result of the *Birnbaum* rule, we think it appropriate to examine the viability of that rule first. For purposes of decision, therefore, we assume that the only purchase or sale of a security involved in the transaction was the transfer of 7,000 shares of stock from Bank Service to Waite, and we reject the suggestion that plaintiffs should be characterized as "sellers" of that stock. The question which is thus presented is whether, notwithstanding the fact that they were neither purchasers nor sellers of a security, plaintiffs may obtain relief under Rule 10b-5. In answering that question, we first note that a violation of Rule 10b-5 has been alleged and then consider whether any remedy is available to these plaintiffs.

I.

For present purposes it is conceded that material misstatements and omissions attributable to both GMAC and Waite

3. A subsidiary which operated the business also allegedly became "defunct."

have been adequately alleged. The 7,000 shares of Bank Service stock were unquestionably "securities" within the meaning of Rule 10b-5. It is also settled that the issuance and delivery of such shares constituted a "sale,"[4] and further, that even though the alleged fraud related to the value of the assets acquired, rather than the value of the security delivered, the deception was "in connection with" the sale of a security.[5] Finally, "the fact that the transaction [was] not conducted through a securities exchange or an organized over-the-counter market is irrelevant to the coverage of § 10(b)." *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U. S. 6, 10. In short, defendants do not challenge the conclusion that a violation of Rule 10b-5 has been alleged. Nor would they dispute a federal court's jurisdiction to entertain an appropriate claim by the corporation, Bank Service.[6] The disputed question is whether plaintiffs, as individual shareholders of Bank Service and guarantors of its indebtedness to GMAC, may assert a Rule 10b-5 claim.

II.

The question of plaintiffs' right to relief has three aspects: (a) whether they have "standing," (b) whether they are protected by the rule, and (c) whether overriding considerations of policy should defeat their claim.

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4. See *Dasho* v. *Susquehanna Corp.*, 461 F. 2d 11, 27 (7th Cir. 1972).

5. *Hooper* v. *Mountain States Security Corp.*, 282 F. 2d 195, 201-203 (5th Cir. 1960) *cert, denied* 365 U. S. 814. Not only did the Supreme Court cite *Hooper* with approval in *Superintendent of Insurance* v. *Bankers Life and Casualty Co.*, 404 U. S. 6, 10-11, but the same analysis is applicable to the transaction in the *Bankers Life* case itself. The fraud related to the use of the proceeds of the sale of Manhattan's bonds, rather than the sale of those bonds or even the price at which Manhattan stock was sold to Begole.

6. Presumably such a claim, at least for rescission, would have no value since the 7,000 shares of Bank Service stock which might be recovered are now worthless.

A.

Neither the statute nor Rule 10b-5 expressly authorizes a private remedy. Nevertheless, in a 1946 decision which is now universally followed, Judge Kirkpatrick held that a civil action could be maintained by a member of the class "for whose special benefit the statute was enacted."[7] The *Birnbaum* case, decided six years later,[8] has been read as holding that only the purchaser or the seller of a security may maintain such an action; this purchaser-seller limitation has been frequently described as a "standing requirement."

This "standing requirement" may be interpreted in two quite different ways. On the one hand, it may signify that only purchasers or sellers of securities have legal rights that are protected by Rule 10b-5. In this sense, the analysis of the plaintiff's status—that is to say, his relationship to defendant's violation of Rule 10b-5—really determines whether the plaintiff is a person who has suffered a legal wrong.[9]

On the other hand, as the term "standing" is more properly used, it assumes that the plaintiff is a member of the class protected by the rule at issue, and addresses the question whether he has a sufficient interest in a real controversy with the defendant to entitle him to invoke the jurisdiction of a federal court. Thus, for example, although a taxpayer, in common with the rest of the citizenry, may be protected by the rule he invokes, he may lack standing to litigate an issue because of

7. *Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512, 514 (E. D. Pa. 1946).

8. *Birnbaum* v. *Newport Steel Corp.*, 193 F. 2d 461 (2d Cir. 1952), *cert. denied*, 343 U. S. 956 (A. N. Hand, J.).

9. *Cf.*, Judge Cardozo's classic analysis in *Palsgraf* v. *Long Island Railroad*, 162 N. E. 99, 100 (N. Y. 1928): "What the plaintiff [seeking to sue in tort] must show 'a wrong' to herself, i.e., a violation of her own right, and not merely a wrong to someone else, in conduct 'wrongful' because unsocial, but not 'a wrong' to anyone else."

the "case" or "controversy" limitation on the exercise of federal judicial power. *Frothingham* v. *Mellon*, 262 U. S. 447. In this sense, the requirement that the plaintiff must have "standing" raises a jurisdictional question under Article III of the United States Constitution.[10]

The *Birnbaum* rule has been interpreted as a standing requirement in this constitutional and jurisdictional sense.[11] We are satisfied that such an interpretation of *Birnbaum* is unwarranted and we have no doubt that the plaintiffs' interest in the controversy before us is sufficient to satisfy the requirements of Article III. Indeed, the parties with a vital stake in the outcome of the dispute are the individual plaintiffs on the one hand and GMAC on the other. One or the other will suffer a loss of approximately $300,000—the balance allegedly due on the loans made by GMAC to which plaintiffs' guarantees apply. This dispute may certainly be regarded as a "case" or "controversy" between these parties within the meaning of Article III.

In the *Birnbaum* case itself Judge Hand made no reference to the Constitution and did not mention the word "standing."

10. Professor Wright summarizes the scope of the doctrine as follows:

> "The law of standing is almost exclusively concerned with such public law questions as determinations of constitutionality and review of administrative or other governmental action. In theory, of course, it is not so limited. The person suing for breach of contract or for a tort must satisfy the court that he has standing to bring such a suit, but in practice such suits are brought only by persons harmed by the supposed wrong, and his standing to sue is self-evident. It is only where the question is of a public nature that the interested bystander is likely to attempt suit." C. A. WRIGHT, FEDERAL COURTS, § 13, p. 39 (1970 ed.).

11. See *Herpich* v. *Wallace*, 430 F. 2d 792, 805 (5th Cir. 1970); *Mount Clemens Industries, Inc.* v. *Bell*, 464 F. 2d 339, 343 (9th Cir. 1972). In the latter case the court stated that the purchaser-seller limitation is "required as a matter of constitutional necessity." See, also, *Manor Drug Stores* v. *Blue Chip Stamps*, ... F. 2d .... (9th Cir. Oct. 15, 1973), slip opinion at p. 15 (Hufstedler, J., dissenting).

The decision in that case turned on the court's evaluation of the kind of conduct which was forbidden by Rule 10b-5. The court concluded that the rule was "directed solely at that type of manipulative or fraudulent practice usually associated with the sale or purchase of securities . . ." 193 F. 2d at 464. Since the rule at that time was thought to relate only to public sales of securities, the prohibition of that type of activity was quite reasonably undersood as intended to afford "protection only to the defrauded purchaser or seller." *Ibid.* As conceived by its author, the purchaser-seller limitation was thus a description of the court's understanding of the class of persons protected by Rule 10b-5.

Instead of stating the issue in terms of standing, we think it is more useful to ask whether the plaintiffs were members of the class for whose special benefit Rule 10b-5 was adopted. This is the inquiry which is suggested in Judge Kirkpatrick's opinion which originally articulated the basis for finding an implied private remedy under Rule 10b-5.[12]

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12. Thus, at page 513 of 69 F. Supp. he stated:

> "It is also true that there is no provision in Sec. 10 or elsewhere expressly allowing civil suits by persons injured as a result of violation of Sec. 10 or of the Rule. However, "The violation of a legislative enactment by doing a prohibited act, or by failing to do a required act, makes the actor liable for an invasion of an interest of another if; (a) the intent of the enactment is exclusively or in part to protect an interest of the other as an individual; and (b) the interest invaded is one which the enactment is intended to protect. * * *' Restatements, Torts, Vol. 2, Sec. 286. This rule is more than merely a canon of statutory interpretation. The disregard of the command of a statute is a wrongful act and a tort. As was said in Texas & Pacific R. Co. v. Rigsby, 241 U. S. 33, 39, 36 S. Ct. 482, 484, 60 L. Ed. 874, "This is but an application of the maxim, Ubi jus ibi remedium.' "

And on the following page:

> "The other point presented by the defendants is that, under the general rule of law, civil liability for violation of a statute accrues only to a member of a class (investors) for whose special benefit the statute was enacted—an argument applied to both Sec. 10 and to Rule X-10B-5. Sec. 10 prohibits

B.

Judge Hand's formulation of the "*Birnbaum* rule" in 1952 was an identification of the persons to whom Rule 10b-5 "extended protection." Protection against the type of fraudulent practice usually associated with the sale or purchase of securities appropriately extended "only to the defrauded purchaser or seller." In the last two decades, however, the rule has been interpreted to encompass additional types of misconduct and to extend protection to a variety of persons not included within the traditional definition of either purchaser or seller. Thus, issuers,[13] trust beneficiaries,[14] merging corporations,[15] minority shareholders in short form mergers,[16] parties to incomplete transactions,[17] offerees,[18] and others[19] have been treated as though they were sellers and thereby accorded the protection of the rule. The course of judicial decision since 1952, when *Birnbaum* was decided, has actually recognized that the class of protected persons is broader than merely purchasers and sellers.

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deceptive devices 'in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.' I cannot agree, however, that 'investors' is limited to persons who are about to invest in a security or that two men who have acquired ownership of the stock of a corporation are not investors merely because they own half of the total issue."

13. *Hooper* v. *Mountain States Security Corp.*, *supra.*

14. *James* v. *Gerber Products Co.*, 483 F. 2d 944 (6th Cir. 1973).

15. *Dasho* v. *Susquehanna Corp.*, 380 F. 2d 262, 267 (7th Cir. 1967), (Fairchild, J., concurring), *cert. denied Bard* v. *Dasho*, 389 U. S. 977; see also *Dasho* v. *Susquehanna Corp.*, 461 F. 2d 11, *supra.*

16. *Vine* v. *Beneficial Finance Co.*, 374 F. 2d 627 (2d Cir. 1967), *cert. denied* 389 U. S. 970.

17. *A. I. Brod & Co.* v. *Perlow*, 375 F. 2d 393 (2d Cir. 1967).

18. *Manor Drug Stores* v. *Blue Clip Stamps*, *supra.*

19. See generally A. R. Bromberg, SECURITIES LAW: FRAUD SEC. RULE 10b-5, § 8.8 (1971).

The language of Rule 10b-5 itself describes any act or practice which operates as a fraud or deceit "upon any person in connection with the purchase or sale of a security." The Supreme Court has repeatedly stated that this language should be given a broad and flexible construction.[20] Construing the words "any person" to include a purchaser or a seller but no one else is not consistent with that admonition. Nor does the so-called rule really have integrity when the words "purchaser" and "seller" are construed as flexibly as has been necessary in order both to decide 10b-5 cases properly and also to continue to pay homage to the *Birnbaum* rule. Moreover, a formal purchaser-seller limitation is not consistent with the overriding requirement that, in construing the 1934 Act, "form should be disregarded for substance and the emphasis should be on economic reality." *Tcherepnin* v. *Knight*, 389 U. S. 332, 336.

Congress, the Supreme Court, and the Commission have all used the term "investors" to describe the class of persons protected by Rule 10b-5. Thus, the statutory authorization for the rule refers to the prohibition of deceptive devices "for the protection of investors."[21] And speaking for a unanimous court in *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, Justice Douglas stated that the crux of the case was the fact that "Manhattan suffered injury as a result of deceptive practices touching its sale of securities *as an investor*." 404 U. S. 6, 12-13 (emphasis added).[22]

In its brief as amicus curiae in that case, the Securities and Exchange Commission also stressed the statutory purpose, implemented by Rule 10b-5, to protect investors from all forms

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20. See, e.g., *Affiliated Ute Citizens* v. *United States*, 406 U. S. 128, 151.

21. See § 10(b) quoted in footnote 1, *supra*.

22. Earlier in the opinion Justice Douglas stated that Manhattan "was injured as an investor through a deceptive device. . . ." 404 U. S. at 10.

of securities fraud.[23] Instead of attaching significance to the fact that Manhattan was the seller of the government securities, the Commission stated: "Manhattan not only suffered an injury as a result of the fraudulent dealings in its government securities, it suffered that injury in its capacity as an investor."[24]

Although no Supreme Court holding is inconsistent with the view that only purchasers or sellers of securities are protected by Rule 10b-5, we thing the Court's opinions fairly imply that the rule was intended to protect a broader class of persons. The emphasis on the injured party's status as an investor indicates that the protection of the rule extends to persons who, in their capacity as investors, suffer significant injury as a direct consequence of fraud in connection with a securities transaction, even though their participation in the transaction did not involve either the purchase or the sale of a security.

The plaintiffs in this case were certainly "investors" in the transaction which is allegedly tainted by fraud. Their interest as stockholders of Bank Service Corporation was apparently sufficient to induce them to execute substantial personal guarantees. As individual guarantors they were direct parties to the transaction in dispute. If, as plaintiffs have alleged, the transaction was consummated in violation of Rule 10b-5, we believe the plaintiffs, as investors and as principals in the transaction, suffered a legal injury which may be redressed by a federal court.

C.

In addition to suggesting that the *Birnbaum* rule is constitutionally compelled, it has been argued that the purchaser-seller

23. "While Congress had no purpose to regulate transactions which comprise no more than internal corporate mismanagement, it sought to protect securities investors, including corporations such as Manhattan, from all forms of securities fraud." Brief for the Securities and Exchange Commission at p. 23.

24. *Id.* at 29.

limitation should be retained to forestall an unmanageable flood of federal litigation,[25] and to preserve national consistency in the interpretation of federal securities legislation.[26] We find neither of these arguments persuasive.

The volume of 10b-5 litigation has already expanded dramatically and will no doubt continue to do so whether or not the purchaser-seller limitation is rejected.[27] The extent to which a refusal to adhere to *Birnbaum* will affect that volume is really a matter of speculation.[28] The fact that the purchaser-seller limitation is unacceptable does not mean that there will be no

25. See, *e.g.*, Judge Hufstedler's dissent in *Manor Drug Stores* v. *Blue Chip Stamps*, ... F. 2d. .... (9th Cir. Oct. 15, 1973), slip opinion at p. 15.

26. See *Mount Clemens Industries, Inc.* v. *Bell*, *supra*, 464 F. 2d at 342.

27. As Judge Wisdom has noted:

> "In recent years, the rule has been applied in such a variety of situations that one can scarcely find an issue of the advance sheets of the Federal Supplement and Federal Reporter that does not contain an opinion on § 10(b). This extraordinary expansion of subject-matter coverage by § 10(b) and Rule 10b-5, coupled with the possibility of extraordinarily great liability, has moved courts to limit the class of persons who may recover to purchasers or sellers of securities." *Rekant* v. *Desser*, 425 F. 2d 872, 877 (5th Cir. 1970).

28. It is not unlikely that the principal cause of concern about the increase in this type of litigation is an assumption that it will always be much easier to allege and prove a 10b-5 case than a common law fraud case. That assumption may not be warranted because it is not necessarily true that the strict standards of disclosure which appropriately apply to transactions in which there is a dramatic disparity in the parties' access to material information will automatically and totally apply to negotiated transactions in which the parties typically rely on contract warranties and pre-closing inspections or audits as a basis for the investment decision. A flexible statute which emphasizes the relevance of the context in which a transaction takes place should neither limit its protection to an arbitrarily defined class of purchasers and sellers, nor arbitrarily assume that every purchaser and every seller is entitled to precisely the same disclosure. See Comment, *The Prospects for Rule X-10B-5; An Emerging Remedy for Defrauded Investors*, 59 YALE L. J. 1120, 1143 (1950).

limit of any kind on the availability of private relief.[29] For in each case the plaintiff will have to demonstrate membership in the "special class" protected by Rule 10b-5 and injury as a direct consequence of the alleged violation. The number of parties who may invoke Rule 10b-5 without the purchaser-seller limitation may not differ materially from the number who would recover by persuading a court to interpret the purchaser-seller concept flexibly.

Assuming, however, that a complete abandonment of *Birnbaum* will significantly increase our workload, we may not for that reason reject what we believe to be a correct interpretation of the statute or the rule. Indeed, the volume of future litigation that was more clearly predictable as a consequence of the Supreme Court's holding in the *Bankers Life* case was not even mentioned in the Court's opinion as a possible objection to its broadened interpretation of Rule 10b-5 as encompassing the misuse of proceeds of sale. The fear that the volume of 10b-5 litigation may actually impair the effective operation of organized securities markets, see *Herpich* v. *Wallace*, *supra*, 430 F. 2d at 804, is not, in our opinion, well founded; but if we are wrong, the Securities and Exchange Commission has both the power and the expertise to adopt appropriate amendments to

29. Section 4 of the Clayton Act expressly authorizes "any person injured in his business or property by reason of" an antitrust violation to sue for damages. Although that broad language opened "nearly limitless possibilities" for damage recovery, a case by case evaluation of what may be described either as the "standing" issue or the concept of injury has resulted in a significant limitation on the potential scope of recovery. See generally *In re Multidistrict Vehicle Air Pollution M. D. L. No. 31*, 481 F. 2d 122 (9th Cir. 1973), and the many cases cited therein. We question whether the rejection of the purchaser-seller limitation in Rule 10b-5 litigation will have any more disastrous consequence than the rejection of any one of the "talismanic rubrics'" identified in that opinion. Either a "target area" or a "direct injury" analysis would seem preferable to a somewhat tattered purchaser-seller rubric. In any event, we deliberately avoid the temptation to try to formulate a succinct substitute for *Birnbaum*, trusting that the appropriate limits to the rule will best be defined through the process of case by case adjudication.

the rule. As the Commission has repeatedly stated, it is now of the view that the purchaser-seller limitation is an artificial restriction inconsistent with the intent of the underlying statute. That view merits our respect.

Nor do we believe that *Birnbaum* should be followed simply to preserve national consistency in the interpretation of federal securities legislation. We are inclined to think that the extent of the consistency in applying *Birnbaum* is overstated[30] and is less important than an independent appraisal of an important issue arising in an area of the law which, despite the age of the statute, is still in an embryonic stage of development. See *Dasho* v. *Susquehanna Corp., supra*, 461 F. 2d 11, 23 at n. 26. In all events, the only sure way to achieve consistency throughout the federal judiciary on a question of this character is for the Supreme Court to resolve such conflict among the circuits as does exist.

As Judge Sprecher demonstrated in *Jannes* v. *Microwave Communications, Inc.*, 461 F. 2d 525, 528-530 (7th Cir. 1972), the basic holding of *Birnbaum* was repudiated by a unanimous Supreme Court in the *Bankers Life* case. We are convinced that the purchaser-seller limitation is nothing more than an appendage to that holding without independent justification. We hold that it is not part of the law of this circuit.[31]

The judgment is reversed and the case is remanded for further proceedings.

30. Bromberg has noted that "the buyer condition has been stretched by broad interpretation to include almost any shareholder affected by a corporate transaction." Bromberg, Securities Law, Vol. 2, § 8.8, p. 222. We also note that our decision in *Dasho* v. *Susquehanna Corp.*, 380 F. 2d 262, *supra*, is frequently cited for the proposition that *Birnbaum* is the law of this circuit. In *Dasho*, however, Judge Fairchild merely explained why the *Birnbaum* formulation would not defeat plaintiff's claim, since merging corporations are both sellers and purchasers of securities. *Id.* at 269-270, cited with approval in *Securities and Exchange Commission* v. *National Securities, Inc.* 393 U. S. 453, 467-468.

31. This opinion has been circulated to all judges in regular active service; no judge has requested that the case be reheard *en banc*.

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

December 28, 1973

Before

HON. ROGER J. KILEY, *Circuit Judge*
HON. JOHN PAUL STEVENS, *Circuit Judge*
Hon. CHARLES EDWARD WYZANSKI, JR., *Senior District Judge**

WILLARD D. EASON, M. O. SATROM and JEAN M. SATROM,
Plaintiffs-Appellants,

No. 72-1722 *vs.*

GENERAL MOTORS ACCEPTANCE CORPORATION and DAVE WAITE PONTIAC, INC.,
Defendants-Appellees.

Appeal from the United States District Court for the Southern District of Indiana.

JUDGMENT.

This cause came on to be heard on the transcript of the record from the United States District Court for the Southern District of Indiana, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said District Court in this cause appealed from be, and the same is hereby, REVERSED, with costs, and the cause be and the same is hereby REMANDED to the said District Court, in accordance with the opinion of this Court filed this day.

* Senior District Judge Charles Edward Wyzanski, Jr., of the District of Massachusetts, is sitting by designation.

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

January 23, 1974

Before

HON. ROGER J. KILEY, SR., *Circuit Judge*
HON. JOHN PAUL STEVENS, *Circuit Judge*
HON. CHARLES E. WYZANSKI, SR., *District Judge*

WILLARD D. EASON, M. O. SATROM and JEAN M. SATROM,
Plaintiffs-Appellants,

No. 72-1722 *vs.*

GENERAL MOTORS ACCEPTANCE CORPORATION and DAVE WAITE PONTIAC, INC.,
Defendants-Appellees.

Appeal from the United States District Court for the Southern District of Indiana, Indianapolis Division.

(IP 71 C 613)

On consideration of the petition for rehearing and suggestion that it be reheard *en banc* filed in the above-entitled cause, no Judge in active service having requested a vote thereon, nor any Judge having voted to grant the suggestion, and all of the members of the panel having voted to deny a rehearing.

IT IS ORDERED that the petition for a rehearing in the above-entitled cause be and the same is hereby DENIED.

APPENDIX II

UNITED STATES DISTRICT COURT
Southern District of Indiana
Indianapolis Division

WILLARD E. EASON, M. O. SATROM and JEAN M. SATROM

vs.

GENERAL MOTORS ACCEPTANCE CORP., DAVE WAITE PONTIAC, INC.

No. IP 71-C-613

Entry for June 20, 1972

HONORABLE CALE J. HOLDER, *Judge*

This cause came before the Court upon the defendant General Motors Acceptance Corporation's motion to dismiss the third amended complaint and each paragraph thereof and the Court being duly advised in the premises now SUSTAINS the motion to dismiss and the action is dismissed as to G. M. A. C. The plaintiffs have no standing to maintain the action against G. M. A. C. under Section 10(b) of Securities Exchange Act of Rule 10(b)5 promulgated thereunder. (*Brinbaum* v. *Newport Steel Corporation*, 2 Circuit, 193 F. 2d 461; and *Jachimiec, etc.* v. *Schenley Industries, Inc.*, 7 Circuit (Feb. 26, 1965) Cause No. 15027.

(C. R. No. 1, p. 25-A.)

UNITED STATES DISTRICT COURT
Southern District of Indiana
Indianapolis Division

WILLARD D. EASON, et al.

vs.

GENERAL MOTORS ACCEPTANCE CORPORATION, and DAVE WAITE PONTIAC, INC.

No. IP 71-C-613

Entry for June 20, 1972

HONORABLE CALE J. HOLDER, *Judge*

This cause came before the Court on the plaintiffs' motion for leave to file fourth amended complaint and for an extension of time to file a notice of appeal. The Court, after considering said motion and being duly advised in the premises, now denies the same.

This cause also came before the Court on the plaintiffs' motion for default. The Court, after considering said motion and being duly advised in the premises, now denies the same.

This cause also came before the Court on the motion of Defendant Waite to dismiss plaintiffs' third amended complaint as to Dave Waite Pontiac, Inc. The Court, after considering said motion and being duly advised in the premises, now SUSTAINS the same, and the action is dismissed without prejudice with costs assessed against plaintiffs.

This cause also came before the Court on the objections of Defendant General Motors Acceptance Corporation to filing of fourth amended complaint. The Court, after considering said objections and being duly advised in the premises, now sustains the same, and the action is dismissed without prejudice with costs assessed against plaintiffs.

(C. R. No. 1, p. 29-A.)